ALQUITY INDIA

INSIGHT TRIP

March 2023

Senior Investment analyst Dan Billis has just returned from India, meeting approximately 40 companies in Mumbai, Chennai and Delhi, in order to feel the pulse of the post-Covid economy.

KEY TAKE AWAYS FROM THE TRIP

- Rural economy stronger than expected, with full recovery in sight
- Infrastructure and hospitality sectors represent an underappreciated opportunity
- Renewable energy usage gaining traction
- ESG disclosure set to significantly improve
- Economic growth remains firm, and poised to accelerate from last quarter's 4.4%

The unveiling of the Union budget in February 2023 by Finance Minister Nirmala Sitharaman has generated a **huge amount of buzz** within the country. "Present Government is on a reform spree", "it's really fantastic", "we have a phenomenal growth trajectory" were some of the comments I received from companies during my meetings.

Surprisingly, there was one area of expenditure that was clearly missing when compared to previous years, namely the populist measures that would typically precede an election year (National elections will take place in 2024). This omission indicates that in line with our investment thesis, the incumbent **BJP government are confident on winning next year**. More importantly, this frees up more funding for crucial, and much needed, infrastructure investment. Government capital expenditure is forecasted to surge 37.4% this year, representing an increase of almost 2.5x since FY21. But it's not just the absolute amount that has increased, as the share of capital spending in total government expenditure is expected to rise to 22.2%.

This represents the highest share in 18 years, and compares to just 12-13% in pre-Covid years. Included in this increase was a boost to aviation and domestic connectivity with an impressive plan to add 50 airports, which will help boost the domestic tourism market. Other measures included the highest ever spending allocation on railways, representing a nine-fold increase when compared to a decade ago.

Infrastructure spending is on the rise...

CapEx increased by 2.5x since FY21

Highest share of government CapEx in 18 years (22.2%)

Spending allocation on railways 9x vs 2013

RURAL INDIA - THE WORST HAS PASSED

Rural India represents approximately half of national income. However, this segment has recently been an issue area for investors as several consumer goods companies had commented on poor sales. My meetings confirmed our concern that the poor localised monsoon (in the context of overall strong nationwide rainfall) in certain areas such as Bihar and Uttar Pradesh have continued to impact rural incomes in these areas. Furthermore, there has more generally been a post-festive season slowness in low ticket durables (clothes, electronics, entry level scooters) as the lower income segments have experienced a much slower and patchier post-covid recovery - as confirmed by our previous Transforming Lives Consumer Panel.

An Amrutanjan store in Chennai.

The company, which has been a core holding of the fund, has a large exposure to rural India.

In contrast, the companies' **future outlook was a pleasantly surprising one**, with widespread upbeat commentaries. Positive signs included tractor sales increasing 14% year-on-year in February (which is a sign of confidence from farmers), healthy water reservoir levels and strong Rabi (Winter) crop sowing. All of this points to a much more resilient rural India than recent data would suggest.

These positive signs are further supported by the **peaking of inflation**, which has been a major contributing negative factor for low-end consumers. Consumer price inflation has already fallen from 7.8% in April to 6.4% currently, and we expect further declines towards our full year forecast of 5%. Hence, this headwind is now abating.

> *I concluded that rural India was more resilient than feared, and a recovery is clearly in sight in the coming quarters.*

INFRASTRUCTURE – SWEET SPOT

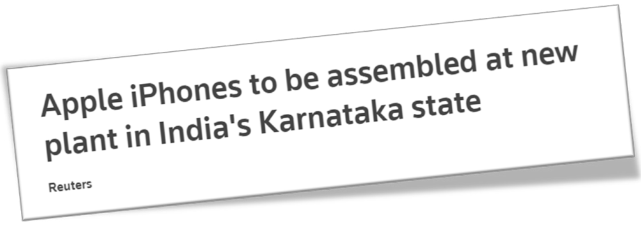
In stark contrast with the patchy rural performance, **all the infrastructure companies that I met were hugely optimistic**, boosted by the substantial increase in Government capital expenditure. Many of the companies were actually struggling to meet orders and consequentially were expanding their capacity at a rapid rate.

This is merely a cyclical **tailwind** to existing significant **structural improvements**. For example, the regulatory environment has improved considerably in the last decade. One company noted that the ease of doing business and setting up new plants had eased noticeably. This was largely due to the digitisation of the application process (with officials also being bound to respond within a certain time frame), but also thanks to the introduction of GST (2017) which greatly simplified the tax regime between different states in India. This is certainly **one of the Modi government's key achievements to date.**

Companies also noted that **momentum has accelerated for the "Made in India" initiative** and also for the "Production Linked Incentive" (PLI) Scheme. The Modi government launched the "Made in India" scheme in September 2014, with the aim of promoting Indian products and manufacturing, reducing dependence on imports, and boosting the country's economy. The Production Linked Incentive Scheme was launched in April 2020, to supplement and enhance this trend.

Investing in Made in India long-term winners...

One example of this trend making headlines recently was the announcement of a new $700m iPhone plant in India. We have been analysing this theme for some time, and this trip has re-affirmed our view that "Made in India", PLI and international companies' "China plus one" strategy (diversifying manufacturing away from China), will result in a **sharp acceleration in manufacturing investment.**


Apple iPhones to be assembled at new plant in India's Karnataka state

Reuters

I also met with a number of beneficiaries of this long-term structural trend such as: **Ultratech Cement**, **Polycab** (wires and cables) and **Prince Pipes** (PVC pipes), and as a result we have further added to our exposure in this area. We were also impressed by the high proportion of renewables in Prince Pipes' energy mix (15.9% FY22).

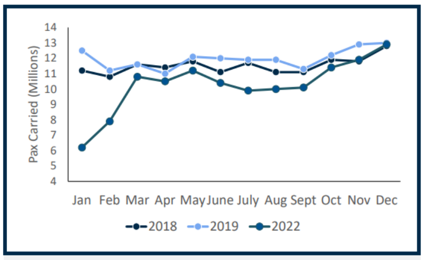
Prince Pipes water tank advertisement, a product that benefits from India's 'Amrut Mission' (aiming to provide basic civic amenities such as water supplies).

HOSPITALITY – STRONG RECOVERY

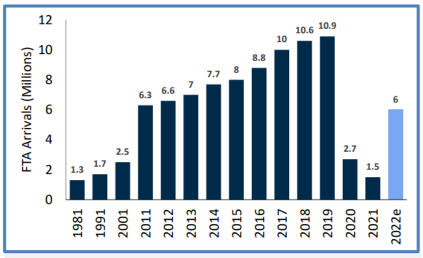
The recovery in travel demand in India has been a gradual process, following the severe impact of the COVID-19 on the industry. In 2021, The Hotel Association of India estimated that 20-25% of the 150,000 branded hotels in India could have faced closure. Many unorganised/informal hotels struggled even more during the pandemic and a significant portion were forced to permanently close their doors. But, as vaccination rates increased and travel restrictions eased, there was a **noticeable bounce back in domestic travel within India**. The implementation of safety protocols and health measures by branded hotel chains played a crucial role in restoring traveller confidence – which only accelerated the **shift from the unorganised/informal lodging segment towards trusted hotel brands.**

Whilst average occupancy for the industry hasn't fully recovered since the pandemic, average room rates are actually significantly higher (e.g. rates are 24% higher for Lemon Tree Hotels, where we have a position). This is driven by the significant supply-demand mismatch; compared with pre-pandemic FY20, hotel demand has grown by 5.4% vs supply growth of just 3.5%. Given it takes 4-5 years for a new hotel to become fully operation after the initial announcement, we expect the favourable supply situation to persist for the coming years. Hence, following our meetings with three hotel chains, **our conviction has further increased in the Indian hospitality sector.**

Domestic air travel fully recovered, steady recovery for foreign tourism.



DOMESTIC DAILY PASSENGERS CROSS
400K in DEC'22
AIR TRAFFIC RECOVERED TO PRE-COVID LEVELS IN DEC'22



FTAs STEADILY RECOVERING
POTENTIAL UPSIDE IN 2023

Source: Smith Travel Research, Chalet Hotels presentation.
*FTA = Foreign Tourist Arrivals

Taj and Ginger hotel rooms, brands from IHCL (Indian Hotels Company).

We have a position in Lemon Tree Hotels, which operates 87 hotels across 53 cities in India.

ESG – NEW MOMENTUM

In our view, **'seeing is believing'** in terms of understanding companies' approach to ESG, and to understand and share regional comparisons of best practice. Hence, given our current substantial weighting in both Indian and Thai hospitality companies, I arranged a site visit with the Indian Hotels Company (India's largest hotel chain). I visited two different Taj hotels (luxury) and a Ginger hotel (economy) as well. My discussion evolved around the treatment of workers during the pandemic, which was a priority for Taj as they retained all permanent staff, unlike many others in the industry who shed staff.

A similar approach was taken by Lemon Tree hotels, who also managed the pandemic without reducing their permanent staff. Furthermore, **Lemon Tree's social initiatives are particularly commendable** – creating opportunities for deprived individuals is a core part of their culture, and around 20% of the group's employees have disabilities (with a goal of 30% by FY26). We had already upgraded Lemon Tree Hotels to a "B" in our bespoke ESG rating system in December 2021, following the release of their first ESG report which included greater disclosure as well as a target of 50% of their electricity requirements from renewable sources by FY26.

One clear trend that I witnessed in numerous meetings was the **introduction of solar panels into companies' energy mix**. For example, Ultratech and Ramco Cement both already utilised 15%+ green energy, with targets to significantly increase this in the coming years. The widespread acceptance of the shift to renewables is a radical and welcome departure from our meetings over recent years, and will help India meet its net zero emissions goal.

Another common theme in my meetings related to the **upcoming enhancements to India's corporate ESG reporting framework**. The Securities and Exchange Board of India (SEBI) is replacing the existing Business Responsibility Reporting (BRR) framework with a new framework: **"The Business Responsibility and Sustainability Reporting (BRSR)"**. India will finally be joining other countries and international organisations that have already released comprehensive sustainability reporting guidelines.

The new framework was highlighted in most of our meetings; companies felt that the data requirements would only be increasing and hence were keen to prepare for this ahead of time. The data provided by early adopters, such as our holding Vmart, is very encouraging. Standardisation and data monitoring will be a key part of India's climate commitments, such as reducing the emissions intensity of their Gross Domestic Product (GDP) by 45% by 2030.

OUTLOOK

India's real GDP grew 4.4% in October-December, down from 6.3% in July-September. However, following my trip, we have concluded that **underlying growth may be stronger** that this might imply, and thus we maintain our expectations for real GDP growth of 7.0% this year and 6.4% for next year. This would represent an acceleration from the current level, driven by infrastructure (where we have increased our weightings) and is in-line with the view of India's chief economic advisor, V. Anantha Nageswaran, who commented that the country is still on track for 7% growth this financial year. **I therefore returned from India with continued confidence in both the near and long term outlook for the country.**

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